

**ACCESS DENTAL PLAN AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**ACCESS DENTAL PLAN AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

General

Access Dental Plan (the "Company") was incorporated in California in 1993 and is regulated by the California Department of Managed Health Care under the Knox-Keene Health Care Services Plan Act of 1975, as amended. The Company operates as a mixed model plan, directly providing dental services and contracting for dental services for its patients and members throughout California. At September 30, 2003, the Company was operating 15 dental clinics throughout Central and Northern California.

In Sacramento County and in Los Angeles County, the Company operates as a dental health care service plan under the California Geographic Managed Care Program (GMC) and the Los Angeles Prepaid Health Plan (LAPHP), respectively. The GMC and LAPHP are administered by the California Department of Health Services (DHS) and were created by the State legislature to ensure access, quality of care, and cost-effectiveness for beneficiaries of the Medi-Cal Program.

The Company also operates as a dental maintenance organization under the Healthy Families Program administered by the State of California. The Company provides and maintains the dental maintenance organization to deliver dental benefits to eligible subscribers in various counties throughout California.

The Company is the majority owner of Premier Access Insurance Company (Premier). Premier is a California C Corporation that commenced business in 1998 as an indemnity specialty insurance company. Premier is regulated by the California Department of Insurance and provides dental insurance and related services primarily to California based employers.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiary, Premier Access Insurance Company. All material intercompany transactions and accounts have been eliminated in consolidation.

Basis of Accounting

The Company maintains its records on the accrual basis of accounting. The Company recognizes patient revenues at the time of treatment for fee-for-service payments. Premium revenue from the GMC contract, LAPHP contract, Healthy Families contract and dental insurance is based on a predetermined prepaid fee and such revenue is recognized in the month in which the related enrollees are entitled to dental services and dental coverage. Premiums collected in advance are recorded as deferred revenue.

## **ACCESS DENTAL PLAN AND SUBSIDIARY**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

#### **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

##### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

##### Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash, cash equivalents, accounts receivable and investments. Management believes the credit risk associated with such instruments is minimal. The Company grants credit and provides services to patients who reside primarily in central and northern California.

##### Cash and Cash Equivalents

Included in cash and cash equivalents are demand deposits and deposits in money market funds. Such deposits are stated at cost, which approximates fair value.

##### Investment Securities

Held-to-maturity investments consist of debt securities, which the Company has the positive intent and ability to hold to maturity and are stated at amortized cost.

Available-for-sale investments consist of debt and equity securities not classified as trading or held-to-maturity. Available-for-sale investment securities are reported at fair value, with unrealized gains and losses excluded from earnings and reported as accumulated other comprehensive income within shareholders equity.

Gains or losses on the sale of securities are calculated using the specific identification method. Unrealized losses that are other than temporary are recognized in earnings.

##### Property, Equipment and Improvements

The Company records these assets at cost. Maintenance and repair costs are expensed as incurred. Depreciation is computed using the straight-line method over the estimated useful lives of the assets or related lease term, whichever is shorter, which generally range from three to ten years. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period.

##### Advertising Costs

Advertising costs are expensed as incurred and totaled \$197,500 for the quarter ended September 30, 2003.

## **ACCESS DENTAL PLAN AND SUBSIDIARY**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

#### **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

##### Reserves for Policy and Contract Claims

Reserves for policy and contract claims are based upon the accumulation of cost estimates for unpaid claims reported prior to the close of the accounting period, together with a provision for the current estimates of the probable cost of claims that have occurred but have not yet been reported. Such estimates are based on many variables including individual cases for reported losses, estimates of unreported losses using historical and statistical information and other factors. The methods for making such estimates and for establishing the resulting reserves are continually reviewed and updated, and any adjustments resulting therefrom are reflected in current operations. Estimates in reserves are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate amount of claims and the related expenses paid are dependent on future developments, management is of the opinion that the reserves for policy and contract claims are adequate to cover such claims and expenses as of September 30, 2003.

##### Income Taxes

The Company elected to become an S Corporation for federal and state income tax purposes on January 1, 1997. For state income tax purposes, the Company is taxed at 1.5% of taxable income. For federal tax purposes, income is taxed at the shareholder level. Prior to that time, the Company was a C Corporation for federal and state income tax purposes.

Upon conversion to an S Corporation, appreciated assets must be evaluated for income tax purposes. The difference between the adjusted tax basis and fair market value of the assets is a "built-in-gain" which is subject to C Corporation income tax rates if the asset is sold within a 10-year period of the conversion.

Premier Access Insurance Company is a C Corporation and is subject to federal income taxes. Premium revenues are subject to state taxation for an insurance company.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between reported amounts of assets and liabilities and their tax basis. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

# ACCESS DENTAL PLAN AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

### 2. INVESTMENTS

The amortized cost and fair value of investments at September 30, 2003 are shown below.

#### Available-for-sale:

	2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds	\$ 2,395,056	\$ 112,673		\$ 2,507,729
U.S. Treasury securities and obligations of U.S. government	4,750,000		9,447	4,740,553
Mutual funds	<u>566,691</u>			<u>566,691</u>
	<u>\$ 7,711,747</u>	<u>\$ 112,673</u>	<u>\$ 9,447</u>	<u>\$ 7,814,973</u>

#### Held-to-maturity:

	2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds	\$ 505,869	\$ 46,536		\$ 552,405
U.S. Treasury securities and obligations of U.S. government	1,023,974	44,776		1,068,750
Other Debt Securities	<u>50,000</u>			<u>50,000</u>
	<u>\$ 1,579,843</u>	<u>\$ 91,312</u>	<u>\$ -</u>	<u>\$ 1,671,155</u>

The amortized cost and fair value of debt securities at September 30, 2003 based on contractual maturities are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year through five years	\$ 4,895,056	\$ 5,004,454	\$ 1,579,843	\$ 1,671,155
Due in five through ten years	2,250,000	2,243,828		
Investments not due at a single maturity date:				
Mutual funds	<u>566,691</u>	<u>566,691</u>		
Total	<u>\$ 7,711,747</u>	<u>\$ 7,814,973</u>	<u>\$ 1,579,843</u>	<u>\$ 1,671,155</u>

## ACCESS DENTAL PLAN AND SUBSIDIARY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

#### 3. PROPERTY, EQUIPMENT AND IMPROVEMENTS

Property, equipment and improvements at September 30, 2003 consisted of the following:

	<u>2003</u>
Leasehold improvements	\$ 2,195,233
Machinery and equipment	2,610,453
Furniture and fixtures	963,527
Vehicles	166,729
Software	482,922
Construction in progress	<u>576,173</u>
Total	6,995,037
Less accumulated depreciation and amortization	<u>(4,968,160)</u>
Property, equipment and improvements, net	<u>\$ 2,026,877</u>

#### 4. TRANSACTIONS WITH RELATED PARTIES

During 2002, the Company issued a promissory note to a contracted dental provider. The note allows for a maximum lending of \$250,000 at 0% before the end date of the note and 9% thereafter. The end date of the note is triggered upon termination of the independent contractor relationship between the parties at which time the note balance is immediately due and payable. At September 30, 2003, the amount outstanding and due to the Company was \$245,800.

During 2002, the Company issued three notes receivable to the sole shareholder totaling \$2,098,322 and bearing interest rates ranging from 8% to 8.5%. All notes have a one year term and are collateralized by deeds of trust. One note for \$321,000 is due on December 1, 2003 and the other two notes totaling \$1,777,322 are due on October 1, 2003. At September 30, 2003, the amount outstanding and due to the Company was \$2,098,322.

During the quarter ended September 30, 2003, Premier issued notes receivable to an officer of the company and another related party totaling \$533,008. These notes are collateralized by deeds of trust and bear interest at 7% with maturities of 7 to 10 years. At September 30, 2003, the amount outstanding and due to the Company was \$533,008.

The Company leases two facilities from the shareholder and one facility from the shareholder and an officer of the Company. Rental expense related to the leases was \$58,200 for the quarter ended September 30, 2003.

## ACCESS DENTAL PLAN AND SUBSIDIARY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

#### 5. LEASE COMMITMENTS

The Company leases certain facilities under noncancellable operating leases. Rental expense related to all operating leases for the quarter ending September 30, 2003 totaled \$331,602. Minimum annual rental commitments on these leases are as follows:

<u>Year Ending</u> <u>December 31,</u>	
2003	\$ 1,221,113
2004	887,333
2005	717,556
2006	516,884
2007	418,188
Thereafter	<u>390,564</u>
	<u>\$ 4,151,638</u>

#### 6. INCOME TAXES

Because the Company is an S Corporation, it has no federal income tax provision. The state income tax provision is due to the 1.5% rate imposed on California S Corporations. A federal provision has been provided for Premier Access Insurance Company, a C Corporation. Premier Access Insurance Company paid state taxes on premium revenues of \$220,720 for the quarter ended September 30, 2003.

The provision for income taxes for the quarter ended September 30, 2003 consisted of the following:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
Current	\$ 401,611	\$ 25,812	\$ 427,423
Deferred			
	<u>\$ 401,611</u>	<u>\$ 25,812</u>	<u>\$ 427,423</u>

## ACCESS DENTAL PLAN AND SUBSIDIARY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

#### 6. INCOME TAXES (Continued)

Deferred tax assets (liabilities) at September 30, 2003 consisted of the following:

	<u>2003</u>
Deferred tax assets:	
Unearned premiums	\$ 24,000
Discount of loss reserve	6,000
Accrued vacation	23,000
Allowance for doubtful accounts	<u>2,000</u>
Total deferred tax assets	<u>55,000</u>
Deferred tax liabilities:	
Equipment and software	<u>(20,000)</u>
Total deferred tax liabilities	<u>(20,000)</u>
Net deferred tax asset (liability)	<u>\$ 35,000</u>

A valuation allowance is provided to reduce deferred tax assets to a level which, more likely than not, will be realized.

#### 7. REGULATORY REQUIREMENTS

##### Access Dental Plan

As a licensed plan under the Knox-Keene Health Care Service Plan act of 1995 (the "Act"), the Company is required to maintain a minimum level of tangible net equity. The required tangible net equity level is approximately \$2,271,000 at September 30, 2003 and can fluctuate in accordance with a formula which is based on premium revenues and Dental Plan expenditures. The Act also requires the Company to maintain a \$50,000 restricted deposit which is included in other assets. At September 30, 2003, the Company was in compliance with these regulatory requirements.

##### Premier Access Insurance Company

Under an agreement with the Department of Insurance of the State of California, Premier was required to maintain capital and surplus of at least \$2.3 million as of September 30, 2003. Premier is in compliance with the above requirement.

Premier's ability to pay dividends to its shareholders is limited to the greater of ten percent of the preceding year policyholder surplus (to the extent that such payments would not reduce the capital and surplus level below the agreed upon minimum of \$2.3 million), or the net gain from operations for the prior year. Further, dividend payments must be approved by the insurance commissioner of the Department of Insurance of the State of California. There were no dividends declared or distributed in the quarter.

Premier's reported capital and surplus of approximately \$9,335,000 was in excess of the authorized control level risk-based capital at September 30, 2003.

## **ACCESS DENTAL PLAN AND SUBSIDIARY**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

#### **8. COMMITMENTS AND CONTINGENCIES**

The Company is a party to claims and lawsuits arising in the ordinary course of business. While the outcome of these matters is not presently determinable, in the opinion of management, they are not expected to have a material effect on the financial position or results of operations of the Company.

The Company has two lines of credit with Sacramento Commercial Bank with a maximum credit limit of \$4,000,000. These lines of credit are secured by the assets of the Company and its sole shareholder. There were no borrowings outstanding under these arrangements as of September 30, 2003.

#### **9. DEFINED CONTRIBUTION PENSION PLAN**

The Company has a defined contribution pension plan for its employees. Employees are eligible for participation in the pension plan after three months of credited service and may contribute up to 15% of their annual salary. The Company has the discretion to make matching contributions each year which are subject to a vesting schedule. There were no matching contributions made during the quarter.